

Corn Market Weakens Slightly After Mid-January Rally - Ethanol Continues to Fuel Market Cotton Market Remains Weak as USDA Increased Production and Lowered Offtake

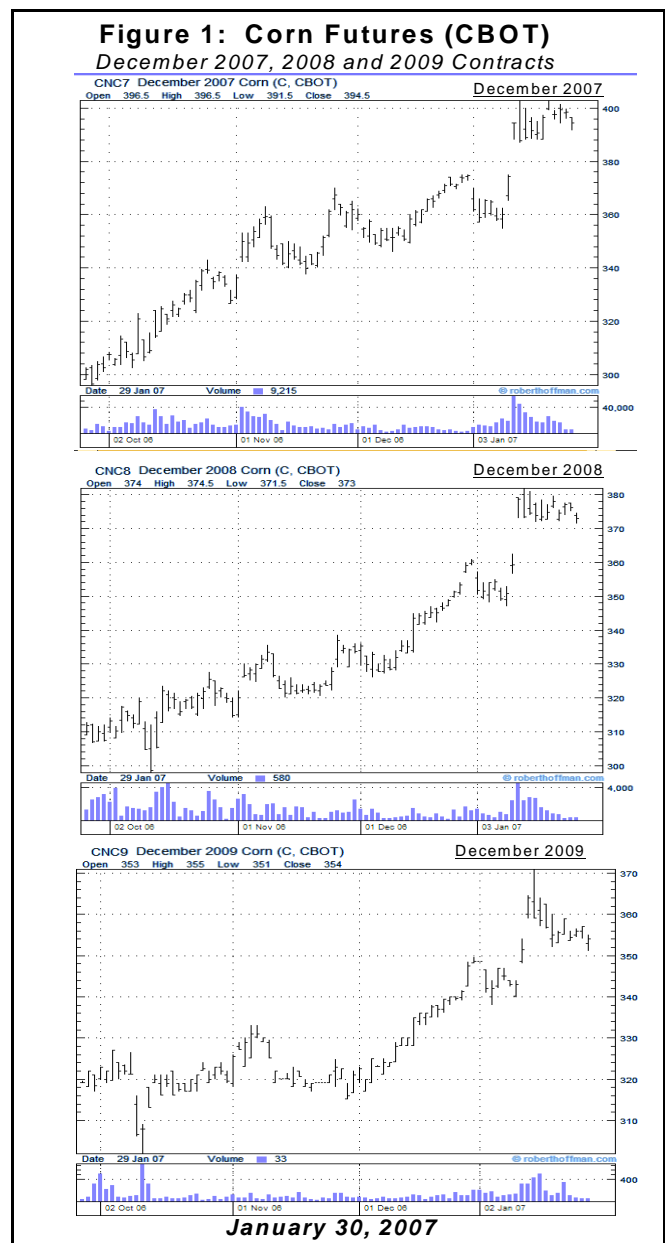
Jose G. Peña, Professor and Extension Economist-Management

Corn futures markets closed about a nickle lower in the Chicago Board of Trade (CBOT) on Monday (1-30-07), apparently influenced by increased sales of futures contracts as fund investors harvested profits by liquidating positions. While the corn market remains volatile, the market is providing excellent pricing opportunities for the '07, '08 and '09 corn crop. (See Figure 1)

Price bids rallied shortly after USDA's January 12, 2007 supply/demand report was released, lowering the final '06/'07 corn production estimate by 210 million bushels from the mid-December estimate. In addition, President Bush's remarks in his "State of the Union" address for an even more aggressive national push towards fuel conservation and alternative fuels might have influence the rally.

After the report was released, futures prices moved sharply higher with limit-up prices for near-by contracts, through July 2008. While the lower production estimate surprised the market, which had expected an even lower estimate, it appears that the adjustment was not a large-enough change in corn fundamentals to warrant a significant rally and now a price slide.

As increased demand for ethanol production fuel futures price bids to 10-year highs and crude oil prices weaken, the corn market has become very volatile. Biofuel production profits have shrunk substantially during recent months as corn prices soar.



Since biofuel production is driving the corn market, the recent downward momentum in crude oil and ethanol fuel prices is having a big impact on the corn market. Crude oil prices have receded since last summer when they hit \$77 a barrel and are now hovering around \$55 a barrel. Futures price bids for ethanol have weakened from mid-June's highs of about \$3.95/gallon down to Tuesday's (1-30-07) futures market close of \$1.98/gal for February deliveries.

It appears that some futures market traders are rolling-over long positions, thinking that near-term demand for biofuels is waning on account of high corn prices. Also, the recent surge in the corn market appears to be causing some exporters and feed producers to back away from corn as their main feed grain. In addition, poultry and other related livestock inventories are down and while the January 1, 2007 cattle inventory is expected to increase slightly, cattle are being finished at lighter weights. This means a potential for reduced domestic demand for corn. But, it appears doubtful that the recent increase in demand for corn will wane during the next couple of seasons.

In the longer term, the profitability of many alternative fuels, without sizable subsidies, is still in question. This is especially true now that the cost of raw ingredients used to produce "biofuels," including corn, has rocketed, squeezing profit margins for producers of those fuels. As the outlook for alternative fuels clouds, some analysts see a more positive outcome from the latest market turbulence, i.e., soaring corn prices; weakening oil/fuel prices. This relationship may force a redirection of resources toward the production of alternative fuels from resources that are more efficient and sustainable than current resources. Investors are directing more money into "cellulosic" fuels that use non-food commodities such as switch grass or farm waste to make ethanol. If this transition occurs during the next 10-15 years, corn price discovery may revert to traditional food/feed demand.

Corn

USDA'S 210 million bushel corn production adjustment in the January 12, 2007 supply/demand report was the largest downward adjustment for production from November to January on record. While the estimate of exports was increased by 50 million bushels, domestic use was decreased by 80 million bushels for a net effect of reducing the estimate of total use by 30 million bushels. (See Table 1)

TABLE 1. U.S. CORN SUPPLY ESTIMATES/1						
	U.S.					
	2004	2005	2006/07		% CHNG	
			December	January	Dec./Jan. 2006/07	Jan. 2006/07
Million bushels						
BEGINNING STOCKS	958	2,114	1,971	1,967	-0.2%	-7.0%
PRODUCTION	11,807	11,114	10,745	10,535	-2.0%	-5.2%
IMPORTS	11	9	10	10	0.0%	11.1%
TOTAL SUPPLY	12,776	13,237	12,726	12,512	-1.7%	-5.5%
DOMESTIC USE	8,844	9,122	9,590	9,510	-0.8%	4.3%
EXPORTS	1,818	2,147	2,200	2,250	2.3%	4.8%
TOTAL USE	10,662	11,269	11,790	11,760	-0.3%	4.4%
ENDING STOCKS	2,114	1,967	935	752	-19.6%	-61.8%
AVG FARM PRICE ²	\$2.06	\$2.00	\$3.10	\$3.20	3.2%	60.0%
USE-TO-SUPPLY	83.5%	85.1%	92.6%	94.0%	1.5%	10.4%
ENDING STOCK-TO-USE	19.8%	17.5%	7.9%	6.4%	-19.4%	-63.4%

¹ SOURCE: USDA/NASS/ERS/WASDE January 12, 2007 Supply/Demand Report
² Corn in bushels

Use will exceed production by 1.225 billion bushels, lowering ending stocks to 752 billion bushels, down 19.6 percent from the December '06 estimate of 935 million bushels and down 61.8 percent from last season's endings stocks of 1.967 billion bushels.

USDA's January '07 projected price range for corn was up 10 cents on each end of the range to \$3.00-\$3.40 per bushel, compared with December '06 estimate.

Cotton

Meanwhile, the cotton market remains weak. USDA's January 12, 2007 supply/demand report for the U.S. indicated increased production and lower offtake, resulting in an increase of 12.7 percent in forecast ending stocks. The production estimate at 21.7 million bales, up two percent from December '06 estimate, was due primarily to higher production in Texas and the Southeast. Domestic mill use was reduced 100,000 bales to 5.0 million bales, reflecting the recent downward trend in monthly mill use. Exports were lowered 300,000 bales to 15.7 million bales, due to the continued sluggish pace of export sales and shipments and a significant reduction in the import forecast for China. If realized, the carryover stocks at 7.1 million bales will be the largest since the 2001/02 season. (See Table 2)

The cotton market remains stagnant. December '07 futures prices weakened to the mid-50's shortly after the report release date, but showed a slight recovery to close at about 59 cents on Tuesday (1-30-07).

With U.S. cotton exports accounting for 72 percent of production, the world cotton situation is keeping a heavy lid on the U.S. cotton market. Globally, the production estimate was increased by 0.7 percent, but the increased production was partially offset by higher estimate of consumption. The estimate of ending stocks at 52.26 million bales, up two percent from last month's estimate, indicate that ample supplies are available to keep a lid on the market.

TABLE 2. U.S. COTTON SUPPLY ESTIMATES/1							
	U.S.						
	2004	2005	2006/07		% CHNG		
			December	January	Dec./Jan. 2006/07	Jan. 2006/07	
Million bales							
BEGINNING STOCKS	3.45	5.50	6.05	6.05	0.0%	10.0%	
PRODUCTION	23.25	23.89	21.30	21.73	2.0%	-9.0%	
IMPORTS	0.03	0.03	0.03	0.03	0.0%	0.0%	
TOTAL SUPPLY	26.73	29.42	27.38	27.81	1.6%	-5.5%	
DOMESTIC USE	6.69	5.89	5.10	5.00	-2.0%	-15.1%	
EXPORTS	14.44	18.04	16.00	15.70	-1.9%	-13.0%	
TOTAL USE	21.13	23.93	21.10	20.70	-1.9%	-13.5%	
ENDING STOCKS	5.50	6.05	6.30	7.10	12.7%	17.4%	
AVG FARM PRICE ²	\$0.416	\$0.477		0.464		-2.7%	
USE-TO-SUPPLY	79.0%	81.3%	77.1%	74.4%	-3.4%	-8.5%	
ENDING STOCK-TO-USE	26.0%	25.3%	29.9%	34.3%	14.9%	35.7%	

¹ SOURCE: USDA/NASS/ERS/WASDE January 12, 2007 Supply/Demand Report

² \$/Lb for August 2006